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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE REORGANIZATION
OF UNS ENERGY CORPORATION.

Docket Nos. E-04230A-14-0011
E-01933A-14-0011

NOTICE OF FILING DIRECT
TESTIMONY OF ARIZONA
INVESTMENT COUNCIL

Pursuant to the requirements of the Procedural Orders dated January 28, 2014 and April 18, 2014 in this matter, attached is the Direct Testimony of Gary Yaquinto on behalf of the Arizona Investment Council. Your assistance is appreciated.

RESPECTFULLY SUBMITTED this 30th day of April, 2014.

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Original and 15 copies filed this
30th day of April, 2014, with:

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Direct Testimony

of Gary Yaquinto

on Behalf of

Arizona Investment Council

April 30, 2014

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I. QUALIFICATIONS

Q. Please state your name, position and business address.

A. Gary M. Yaquinto. I am President and CEO of the Arizona Investment Council ("AIC"). Our offices are located at 2100 North Central Avenue, Phoenix, Arizona 85004.

Q. Please summarize your educational background and professional experience.

A. I earned B.S. and M.S. Degrees in Economics in 1974 from Arizona State University, as well as an MBA from the University of Phoenix in 2005. From 1975 to 1977, I was employed by the State of Wyoming as an economist responsible for evaluating the economic, fiscal and demographic effects of resource development in Wyoming. From 1977 to 1980, I served as Chief Research Economist for the Arizona House of Representatives and from 1980 to 1984 was employed as an economist in the consulting industry. Since 1984, I have worked in various capacities in government and the private sector in the area of utility regulation, including positions with the Commission's Utilities Division Staff, a competitive local exchange telephone carrier and as a consultant. I also served as the Chief Economist at the Arizona Attorney General's Office from 2003-2005 and was the Director of the Governor's Office of Strategic Planning and Budgeting from 2005-2006. I became AIC's President in December of 2006.

II. ARIZONA INVESTMENT COUNCIL ("AIC")

Q. What is the Arizona Investment Council and what is its mission?

A. The AIC is a non-profit association organized under Chapter 501(c)(6) of the Internal Revenue Code. AIC's membership includes several Arizona utilities, as well as approximately 6,000 individuals—many of whom are debt and equity investors in Arizona utilities and other Arizona businesses.

AIC's mission is to advocate on behalf of its members' interests, primarily before regulatory bodies as well as the Legislature and, specifically, to enlarge and maximize the influence of utility investors on public policies and governmental actions that impact investors and their investments.

AIC also works with the Commission and policymakers generally to find ways to support investment in Arizona's essential backbone infrastructure, as well as improvements to, or remediation of, existing facilities. We view this aspect of our mission as complementary to our core advocacy of investor interests.

III. TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to support the proposed acquisition of UNS Energy by Fortis, Inc. The transaction will strengthen UNS Energy and its Arizona Utilities (Tucson Electric Power, UNS Electric and UNS Gas), leading to improved credit ratings and a lower cost of capital. Among other things, Fortis' injection of \$200 million of

1 capital will strengthen UNS' balance sheet, providing funds for TEP's and UNS
2 Electric's diversification of their generation portfolios. The merger with a financially
3 strong Fortis will also facilitate access to capital markets on more favorable rates, terms
4 and conditions.

5
6 **Q. How will the Fortis Acquisition strengthen the financial positions of UNS Energy**
7 **and the Arizona Utilities?**

8 A. As company witnesses Bonavia and Hutchens point out, UNS Energy anticipates needing
9 \$2 billion for new capital investments over the next five years to serve customers of the
10 Arizona Utilities. About one-half of that is aimed at projects in the next two years.
11 Obviously, that requires access to debt and equity financing.

12
13 Fortis has agreed to infuse \$200 million of equity capital (10 percent of this total need)
14 into UNS Energy upon completion of the transaction. From the testimony of UNS
15 witness Larson, "UNS Energy will either invest the \$200 million as equity into TEP and
16 UNS Electric, retire UNS Energy shorter-term debt, or some combination of the equity
17 contribution and debt retirement" (Kevin Larson Direct Testimony, p. 4, ll. 22-24).
18 Obviously, that will deliver a more balanced consolidated capital structure and will
19 improve UNS' percentage of common equity-to-debt from 42.6 percent to 44.1 percent.

20
21 Further, the \$200 million Fortis equity infusion will be a major component of the
22 financing needed to complete the purchase of the Gila River Power Plant ("GRPP")
23 Unit 3 by TEP and UNS Electric. This gas-fired Unit 3 acquisition is critical to TEP's

1 and UNS Electric's plans to serve customers reliably and cost effectively in the face of
2 increasingly stringent environmental regulations on coal-fired assets.

3
4 **Q. Is the proposed transaction likely to improve the credit ratings of UNS Energy and**
5 **the Arizona Utilities?**

6 A. Yes. Two of the three major credit rating agencies issued positive outlooks after the
7 announcement of the transaction.

8
9 Fitch placed the TEP ratings watch on "positive" following announcement of the merger.
10 Fitch referenced improved access to capital based on Fortis' financial strength and the
11 \$200 million equity infusion as two of the reasons for the positive outlook (Fitch Ratings,
12 "Fitch Places Tucson Electric Power Co.'s Ratings on Rating Watch Positive on Merger
13 Announcement," December 13, 2013).

14
15 Similarly, Standard & Poor's Ratings Services raised TEP to "positive" from "stable,"
16 further indicating a credit upgrade is possible if the merger does not add debt to TEP or
17 UNS Energy (Standard & Poor's Ratings Services, *Ratings Direct*, December 13, 2013).

18
19 Finally, Moody's Investor's Service stated: "Fortis' potential ownership to be credit
20 neutral to slightly positive for UNS as the utility would have access to Fortis' larger scale
21 and scope which may help with the funding of capital expenditures, reduce certain
22 operating costs and provide access to the capital markets" (Moody's Investor Service,
23 December 12, 2013).

1 **Q. Earlier in your testimony, you stressed the importance of Fortis' infusion of**
2 **\$200 million equity capital into UNS Energy. Please expand on that point.**

3 A. TEP's current generation portfolio is heavily weighted toward coal-fired generation. In
4 fact, 80 percent of TEP's load is met by coal assets. While those assets have served
5 TEP's customers with reliable and affordable electricity, compliance with recent and
6 future environmental regulations will require investments in costly emissions technology
7 on aging coal facilities that might be nearing the end of their useful lives. Consequently,
8 TEP and utilities nationwide are evaluating alternatives to meet load requirements,
9 including replacing older coal assets with cleaner technologies, including combined cycle
10 natural gas plants like GRPP. Further, the closure of two units at San Juan in New
11 Mexico by 2017, coupled with TEP's decision to reduce its reliance on coal-fired
12 Springerville Unit 1, requires TEP to acquire new resources to fill that supply gap.

13
14 The cost of acquiring GRPP Unit 3 is estimated at \$219 million. Obviously, Fortis'
15 commitment to infuse \$200 million is coming at a very critical time for the Companies.
16 In this regard, I also note that TEP's 2014 Integrated Resource Plan (filed with the
17 Commission on April 1, 2014) lays out the company's plan for reducing its dependence
18 on coal generation from the current 80 percent to 57 percent by 2020.

19
20 **Q. In what other ways is the proposed transaction positive for the customers,**
21 **employees and communities served by the Arizona Utilities?**

22 A. Fortis is Canada's largest investor-owned utility company and has a proven success
23 record not only in Canada but, as well, New York State and the Caribbean. Fortis'

1 standard practice allows its subsidiaries to be managed locally on a stand-alone basis.
2 Thus, local utilities maintain all characteristics of a "home-based" utility, including
3 customer care relationships, connection with community and civic activities and ongoing
4 relationships with its workforce.

5
6 Specifically, Mr. Hutchens summarizes Fortis' commitments in these areas, including:

- 7 - Support of existing levels of charitable and community contributions;
- 8 - Maintenance of existing low-income programs;
- 9 - Maintenance of existing employment and employee benefits for at least two
10 years; and
- 11 - Honoring existing collective bargaining agreements.

12
13 **Q. Are UNS Energy and Fortis proposing conditions to address potential financial**
14 **concerns about the acquisition from the standpoint of the Arizona Utilities?**

15 A. Yes. UNS and Fortis have agreed to several measures to ensure that the Arizona Utilities
16 are shielded from risks associated with Fortis' other operations and to ensure that the
17 Arizona Utilities' customers continue to receive high quality, safe and reliable service at
18 reasonable prices.

19
20 These conditions are fully explained in the testimonies of Messrs. Hutchens (Direct,
21 pp. 8-14) and Larson (Direct, pp. 10-11). Of particular note are the financial protections
22 outlined by Mr. Larson. These include an agreement that the Arizona Utilities will not
23

1 financially support Fortis or its affiliates absent ACC authorization; and a stipulation that
2 Fortis cannot have cross default provisions that implicate or affect the Arizona Utilities.
3

4 **Q. Mr. Yaquinto, your testimony so far has addressed the proposed merger from the**
5 **perspective of the Arizona Utilities and their customers. How do you view Fortis'**
6 **position in the transaction?**

7 A. I found very interesting Fortis' CEO H. Stanley Marshall's comments that, because his
8 company expects Arizona's economy to outperform other U.S. states, that "will provide
9 Fortis with opportunities for capital investment to meet the future needs of the Arizona
10 Utilities' customers."¹ So, somewhat uniquely, the strength of this Fortis acquisition lies
11 not only in its current benefits and capital infusions, but also in the fact Fortis sees it as
12 an ongoing investment opportunity.
13

14 **Q. You mentioned geographic diversity earlier. Please elaborate.**

15 A. Fortis has regulated electric and gas operations in five Canadian provinces, the State of
16 New York and two Caribbean countries, together with non-regulated generation and
17 commercial real estate/hotel operations. Fortis' regulated utilities account for
18 approximately 90 percent of its total assets. Adding the Arizona Utilities' operations in
19 our southwestern U.S. state further enhances the stability and diversity of all of the
20 organization's component parts. Slowdowns or negative economic trends in some areas
21 or economic sectors are likely to be offset by positives and gains in operations and areas
22 elsewhere. Further, from a credit ratings standpoint, all but one of the utilities in the

23 ¹ Marshall Direct, p. 10.

1 Fortis' group has ratings that are superior to the UNS Energy, TEP and UNS Electric and
2 Gas ratings. The combination of the two organizations will redound to Arizona's benefit
3 and, correspondingly, further strengthen Fortis' profile.
4

5 **Q. Are there other aspects of Fortis' operation which you'd stress?**

6 A. I was particularly impressed by CFO Barry Perry's discussion of Fortis' financial
7 strength, equity issuances and liquidity at pages 6-7 of his Direct Testimony. Most
8 remarkable was the fact that, notwithstanding the exceptionally challenging credit crisis
9 of 2008, Fortis raised nearly C\$1.2 billion in capital markets that year.
10

11 Although Fortis makes clear that each utility—including the Arizona Utilities—is
12 financed on a stand-alone basis, Fortis' experience and strengths in these areas will
13 undoubtedly benefit the Arizona Utilities and their customers. Additionally, the proposed
14 protections concerning legal separateness and elimination of potential cross defaults on
15 parent and subsidiary financial transactions, as discussed previously, provide a measure
16 of financial insulation for the Arizona Utilities.
17

18 **Q. Mr. Yaquinto, in his testimony, Mr. Hutchens recommends that the Commission**
19 **modify the original 1997 UNS Holding Company Order and basically substitute**
20 **certain provisions of the Order which issues in this proceeding for that Decision.**
21 **Does AIC have a position on that recommendation?**

22 A. While I'd stress that I'm not intimately familiar with the 1997 Decision, the
23 recommendation certainly seems to make a lot of sense. Almost two decades have
24

1 elapsed since its issuance. The recommendation to replace it with appropriate conditions
2 structured in the current case certainly seems like a very rational and cohesive way to
3 proceed.

4
5 **Q. Do you have a recommendation for the Commission?**

6 A. Yes. I recommend the Commission approve the proposed merger.
7

8 **Q. Does this conclude your testimony?**

9 A. Yes, it does.
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